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TO RUEHC/SECSTATE WASHDC 0031
RUEATRS/DEPT OF TREASURY WASHDC
INFO RUCPDOG/USDOC WASHDC
RUEHBK/AMEMBASSY BANGKOK 3256
RUEHBJ/AMEMBASSY BEIJING 5163
RUEHUL/AMEMBASSY SEOUL 7818
RUEHGP/AMEMBASSY SINGAPORE 6441
RUEHKO/AMEMBASSY TOKYO 7692
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RUEHKL/AMEMBASSY KUALA LUMPUR 3492
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UNCLAS SECTION 01 OF 03 TAIPEI 001549

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USTR FOR WINTER AND WINELAND

USDOC FOR 4420/USFCS/OCEA/EAP/LDROKER
USDOC FOR 3132/USFCS/OIO/EAP/ADAVENPORT
TREASURY FOR OASIA/LMOGHTADER
TREASURY PLEASE PASS TO OCC/AMCMAHON
TREASURY ALSO PASS TO FEDERAL RESERVE/BOARD OF
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SUBJECT: Moral Hazard Spurs Delinquent Card Debt

Summary

11. Moral hazard has contributed to a sharp increase in delinquent credit/cash card debt in 2006. This debt remains manageable for Taiwan's banking industry as a whole, but has exposed several foreign and Taiwan banks to significant risks. END SUMMARY.

Moral Hazard

12. Media and legislative pressure has forced the Taiwan authorities to adopt measures to protect consumers from debts incurred, and has thereby created a moral hazard (i.e., a disincentive for doing the right thing, in this case, paying off debt.) Many of Taiwan's card debtors now expect authorities to adopt further measures to lighten their debt burden. This expectation was reinforced when regulators required banks to waive additional interest on card debt if negotiations for rescheduling the debt were started before April 10. The government also set strict limits on the language and methods that can be used by debt collectors (i.e., no threats, contact of family members, or "harassment"). Our banking contacts report that some debtors have intentionally stopped repayment on their debts because they are expecting future relief from an interest rate cap and personal bankruptcy bills now under consideration by the legislature.

Sharp Increase in Delinquent Card Debt

¶3. This moral hazard has contributed to a sharp increase in delinquent card debt. Non-performing loans (NPLs) for credit card holders in March 2006 increased 21% to NT\$14.6 billion (US\$449 million) from the end of 2005, driving up the average NPL ratio for credit card loans from 2.4% to 3.2%. During the same period, NPLs for cash card holders more than doubled from NT\$5.5 billion (US\$168 million) to NT\$11.8 billion (US\$362 million), and the average NPL ratio for cash card loans shot up from 1.8% to 4.4%. The NPL ratios would have been much larger if card issuers had not written-off substantial amounts of bad debt.

Surge in Write-offs

¶4. Card issuers must aggressively write-off delinquent card debts to stay in compliance with the stricter NPL limits established in July 2005. Taiwan regulators will warn or censure card issuers if their delinquency ratio exceeds three percent. Regulators will suspend card issuance authority if the delinquency ratio exceeds eight percent. Card debt-related NPLs written-off in Q1 of this year totaled NT\$47.9 billion (US\$1.5 billion), nearly four times the level of a year ago.

Profitability Eroded

¶5. The growing amount of delinquent card debt written-off contributed to banks losses of NT\$11.6 billion (US\$356 million) in November and of NT\$43.7 billion (US\$1,345 million) in December of ¶2005. In Q1 of 2006, Taiwan banks reported pre-tax profits of NT\$27.3 billion (US\$840 million) which, however, were down 42% from a year ago.

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Problems Remain Manageable

¶6. For most banks, credit/cash cards are just a small part of their business. Card-related NPLs in March totaled NT\$26.4 billion (US\$810 million), equal to 6.5% of Taiwan banks' total NPLs. Outstanding loans to card holders in March totaled 727.8 billion (US\$23.4 billion), accounting for only 4.3% of total bank loans to all borrowers.

¶7. Delinquent card debts pose little threat to Taiwan's financial system. Most of the problem card holders have been taken care of in recent rescheduling negotiations. Of 160,000 card debtors with debts exceeding NT\$300,000 (US\$9,230), the debt of 98,000 persons has already been written-off. Of the remaining 62,000 card debtors, 80% have completed rescheduling negotiations, according to Taiwan regulators.

Card Debt Declines

¶8. Five banks have now stopped issuing new credit cards and three banks have ceased issuing new cash cards. In addition, banks have tightened their issuing standards for credit/cash cards. Outstanding credit card debt declined 7% from NT\$495 billion (US\$15 billion) in December 2005 to NT\$460 billion (US\$14 billion) in March ¶2006. Outstanding cash card debt dropped 10.4% from NT\$298 billion (US\$9.2 billion) to NT\$267 billion (US\$8.2 billion).

¶9. The total value of transactions paid with credit cards dropped 14% from NT\$129.6 billion (US\$4 billion) in December 2005 to NT\$111.7 billion (US\$3.4 billion) in March 2006. Total credit available for cash card holders declined to a 21-month low of NT\$462 billion (US\$28.4 billion) in March. Retail sectors that rely on consumer loans have reported sharp declines in sales of 10-20%.

Limited Exposure to Card Debt

¶10. Outstanding loans to card holders in March were only 3.7% of Taiwan banks' total loans and only 2.2% of their total assets.

However, three Taiwan banks and three foreign card issuers reported card debt/asset ratios exceeding 10%. For one of the three Taiwan banks (Cosmos Bank), its card debt/asset ratio reached 25%, but its NPL ratios were only 1.4% for credit card loans and 1.1% for cash card loans. Among the three foreign banks, one (Standard Charter) reported a NPL ratio of 2.9% for credit card loans with a card debt/asset ratio of 16%.

¶11. Taishin and Cosmos are Taiwan's two largest cash card issuers, accounting for over half of the cash card market. ChinaTrust, Citibank, Cathay United, and Taishin are the four largest credit card issuers, occupying 37% of the credit card market. These five banks all report NPL ratios for card debt of below three percent.

Two Small Taiwan Banks in Trouble

¶12. Two small Taiwan banks reported very poor standings in their credit/cash card business. Chinese Bank reported NPL ratios of 7.9% for credit card loans and 13.3% for cash card loans, with card loans accounting for 18% of its total loans. Another Taiwan bank in trouble is Taitung Business Bank (TBB) whose NPL ratio for cash

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cards hit 30%, the highest amount among cash card issuers. Taiwan's banking regulator, the Financial Supervisory Commission (FSC) Banking Bureau, has put these two banks under close surveillance.

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